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No. 05-1590

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SUPREME COURT, U.S.

In the Supreme Court of the United States

JOHN J. MOORES, ET AL.,
Petitioners,

v.

ROBERT C. FRIESE, AS TRUSTEE,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether this Court has jurisdiction to review the interlocutory decision of the California courts.
2. Whether this Court should review federal constitutional issues not raised in Petitioners' demurrers and thus not addressed by any of the California courts.
3. Whether sections 25402 and 25502.5(a) of California's Corporate Securities Law of 1968, which are expressly limited to securities transactions in California, violate either the Commerce Clause or the Due Process Clause of the United States Constitution.

PARTIES TO THE PROCEEDING

Respondent Robert C. Friese is the Trustee of the Peregrine Litigation Trust (the "Trust"). The Trust is the successor in interest to the Estate of Peregrine Systems, Inc. The Trust, by and through Mr. Friese as Trustee, was the plaintiff in the California Superior Court. Mr. Friese, as Trustee, was the petitioner in the Court of Appeal.

Petitioners John J. Moores, Charles E. Noell, III, Norris van den Berg, Christopher A. Cole, and JMI Services, Inc. were defendants in the Superior Court and real parties in interest in the Court of Appeal.

Pursuant to Rule 14.1(b), Respondent states that the following were parties in the California Court of Appeal proceedings, in addition to those named in the caption:

Rodney Dammeyer
Stephen P. Gardner
Matthew C. Gless
Frederic B. Luddy
Richard T. Nelson
Thomas G. Watrous

In the California Superior Court, the following also were parties in addition to those named in the caption:

Richard A. Hosley II
Douglas S. Powanda
William D. Savoy

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Robert C. Friese respectfully submits this brief in opposition to the petition for a writ of certiorari filed in this case.

OPINIONS BELOW

The order of the Supreme Court of California denying review of the Court of Appeal's decision (Pet. App. 1a-2a) is unreported. The opinion of the Court of Appeal (Pet. App. 3a-26a) is reported at 36 Cal. Rptr. 3d 558 (Cal. Ct. App. 2005). The decision of the Superior Court of California, San Diego County (Pet. App. 27a-31a) is unreported.

JURISDICTION

This Court lacks jurisdiction to review the interlocutory decision of the California courts. That decision is merely an

interim ruling that remands the case for further proceedings (potentially including trial) in the Superior Court. The decision is not a final judgment and does not finally resolve any claims. Petitioners seek to invoke this Court's jurisdiction under 28 U.S.C. § 1257(a), but, as we show in greater detail below, the decision of the California courts does not qualify as a "final judgment or decree" within the meaning of that provision.

STATEMENT OF THE CASE

A. The Parties and History of the Dispute

Petitioners are former officers and directors of Peregrine Systems, Inc. ("Peregrine"), a company that developed and marketed computer software.[1] From 1997 through 2002, Peregrine was a publicly traded Delaware corporation with its headquarters and principal place of business located in San Diego, California. Following its initial public offering in 1997, Peregrine enjoyed substantial success; its annual revenues grew nine-fold from 1997 through the beginning of 2002, and its stock price rose nearly 30-fold from $2.75 per share at its initial public offering to a peak of $79.50 per share in 2000. Petitioners reaped the benefits of the sharp increases in the company's stock price, securing profits of hundreds of millions of dollars from the sales of Peregrine stock. During the summer of 1999, Petitioners collectively sold more than 4.9 million shares of Peregrine stock, and received approximately $120 million in proceeds. During a two-week period in February 2000, Petitioners sold more than 5.3 million shares of Peregrine stock, and received proceeds exceeding $247 million. In the month of February 2001, Petitioners sold more than 3.6 million shares of Peregrine stock and received in excess of $106 million. (Amended Consolidated Complaint at 24-27, 33-36, 48-49.)

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[1] Petitioner JMI Services, Inc. is an investment services firm founded by petitioner John J. Moores.

Much of Peregrine's growth eventually was shown to be the result of pervasive accounting fraud and revenue manipulation. (Pet. App. 9a-11a.) Peregrine had been able to disguise the deterioration of its direct sales by adopting a disfavored accounting method that allowed it to record sales as its products entered the distribution stream, as opposed to when a product was sold to an end-user. In essence, and in the words of its CEO, Peregrine was "borrowing [revenue] from the future" to meet Wall Street expectations. (Amended Consolidated Complaint at 46.) Peregrine's public announcements and Securities and Exchange Commission filings made no mention of these behind-the-scenes machinations. (Pet. App. 10a-11a.) From the perspective of the public and Peregrine's shareholders, Peregrine was meeting or exceeding expectations.

In May 2002, Peregrine finally announced that its earnings had been substantially overstated as a result of the accounting fraud. Peregrine's stock price plummeted, bottoming out at 89 cents per share. Peregrine filed for bankruptcy in September 2002. The bankruptcy proceedings revealed that Peregrine had overstated its profits by more that $500 million, or 38 percent, during the period from April 1999 through December 2001. (Pet. App. 11a.)[2]

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[2] Petitioners rely on a Latham & Watkins Report of Investigation to support their assertion that they were absolved of any wrongdoing connected to the accounting fraud. (Pet. 7.) The Latham & Watkins report, which is not part of the trial court record, is not relevant here. On a demurrer, the allegations set forth in the complaint are presumed to be true; on review, the court is limited to the allegations and matters that are properly the subject of judicial notice. *See Labadie v. California*, 256 Cal. Rptr. 604, 605 (Cal. Ct. App. 1989). Petitioners will have the opportunity to litigate their complicity in the accounting fraud on remand. In the meantime, it is worth noting that Petitioners themselves commissioned the Latham & Watkins report, and their trial counsel participated in its preparation.

The Peregrine Litigation Trust was formed as part of the Peregrine bankruptcy reorganization plan. The bankruptcy estate assigned any claims Peregrine might have against its officers and directors to the Litigation Trust. Respondent Robert C. Friese is the Trustee of the Peregrine Litigation Trust.

B. The Trial Court Proceedings

In February 2004, Respondent Friese, pursuing claims assigned by Peregrine to the Litigation Trust, substituted in as plaintiff in a consolidated action against Petitioners and filed an amended complaint in the San Diego Superior Court. The complaint states ten causes of action against fourteen individual defendants, primarily Peregrine's senior officers and directors, and several trusts controlled by petitioner John J. Moores.[3] (Pet. App. 9a n.2.) The complaint alleges statutory claims for violations of California's insider trading laws, *i.e.*, California Corporations Code §§ 25402 and 25403, and common law claims for breach of the duty of loyalty, breach of the duty of care, waste of corporate assets, conspiracy, and unjust enrichment. (Pet. App. 11a.) The petition in this Court relates only to the statutory insider trading claims; the common law claims remain pending in the trial court.[4]

California Corporations Code § 25402[5] prohibits corporate insiders from purchasing or selling securities in the State of California while possessing non-public material information at a time when the material information would significantly affect the market price of the security. Section 25502.5(a)

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[3] Petitioner Moores was named as a defendant individually and as trustee of twenty-two separate trusts.

[4] The trial court sustained defendants' demurrers challenging the five common law causes of action, but granted Respondent Friese leave to amend all five claims to plead additional facts.

[5] All further statutory references are to the California Corporations Code unless otherwise indicated.

authorizes a corporation or "issuer" to sue for violations of section 25402, thereby adding such suits to investor actions and civil actions or criminal prosecutions by public authorities as means for enforcing the ban against insider trading in California. In support of the statutory insider trading claims in this case, the complaint alleges that when Petitioners sold their Peregrine stock they were aware of material adverse developments in the company not known to the investing public. With this material, nonpublic information in hand, Petitioners sold or transferred stock in California for their personal benefit at artificially inflated prices. (Pet. App. 11a-12a & n.4.)

The various defendants proceeded differently in response to the complaint. Some filed demurrers presenting fully briefed arguments, others briefed only particular arguments directed at select claims and purported to join in the other briefs, and still others argued nothing and merely filed "joinders."

Petitioners Moores and JMI filed a joint demurrer and supporting memorandum of points and authorities. They challenged, *inter alia*, the statutory insider trading claims (counts one through five of the Amended Consolidated Complaint).[6] (Amended Demurrers of Defendants John J. Moores and JMI Services, Inc.) They argued, in relevant part, (1) that Delaware law should govern the insider trading claims because the claims belonged to Peregrine, a Delaware corporation, and, therefore, under the internal affairs doctrine and section 2116,[7] the law of the state of incorporation should control,

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[6] Under California Code of Civil Procedure § 430.50, a demurrer to a complaint "may be taken to the whole complaint . . . or to any of the causes of action stated therein."

[7] Section 2116 provides that the liability of directors of a foreign corporation for violations of "official duty" while transacting business in California is governed by the law of the state of incorporation.

(2) that the complaint fails to allege a cause of action for insider trading under Delaware common law, and (3) that even if California law applied to the securities claims, the complaint fails to state a claim because it does not plead with particularity that defendants (a) knew material information, or (b) sold the stock within the meaning of section 25402.

Petitioners Noell and van den Berg filed a joint memorandum of points and authorities arguing in relevant part that the complaint fails to allege sufficient facts in support of the insider trading claims, and stating in a footnote that they joined in the arguments asserted by Moores and JMI. (Amended Demurrers of Defendants Charles E. Noell, III, Norris van den Berg, and Richard A. Hosley II at 1 n.1, 4, 16.) Petitioner Cole merely filed a joinder in Moores' and JMI's demurrer, stating: "The demurrers in which Cole joins have been made pursuant to *California Code of Civil Procedure* § 430.10(e) and (f), on the grounds that each of the . . . purported causes of action [asserted against Cole] in the Amended Consolidated Complaint fail[s] to set forth sufficient facts to state a cause of action and that the pleading is uncertain." (Joinder by Defendant Christopher A. Cole in Demurrer filed by John J. Moores.)

In all of these hundreds of pages of filings, the only remote hint of a federal constitutional question came in the form of a footnote in petitioners Moores' and JMI's demurrer in which they sought to "reserve all other objections to the purported claims under Cal. Corp. Code § 25502.5, even if not asserted herein." (Pet. App. 34a.)

The trial court sustained Petitioners' demurrers to the statutory insider trading claims. The court held, as a matter of California law, that section 2116 and the internal affairs doctrine require application of Delaware law because "Delaware law governs the relationship between Peregrine and its directors and/or officers." (Pet. App. 29a.) Having held that Delaware law governs, the court's order did not address Peti-

tioners' alternative arguments regarding whether the allegations in the complaint set forth facts sufficient to support a section 25402 claim. (*Id.*)

C. The Court Of Appeal Proceedings

Respondent Friese filed a petition for peremptory writ of mandate with the California Court of Appeal, contending that the trial court erred by disregarding California's securities laws and controlling precedent, both of which compelled application of California law. The Court of Appeal granted the petition in a decision filed December 2, 2005 (Pet. App. 5a-26a), and amended December 29, 2005 (Pet. App. 4a) and January 24, 2006 (Pet. App. 3a).

Before granting the writ of mandate, the Court of Appeal issued an order to show cause requesting briefing from Petitioners, the real parties in interest. (Pet. App. 8a.) Petitioners primarily defended the trial court's reading of section 2116 and the application of Delaware law, but they also unveiled their constitutional arguments for the first time. Ultimately, the court ruled in favor of Respondent's interpretation of California's securities laws and held that the "securities laws are designed to protect participants in California's securities marketplace and deter unlawful conduct which takes place [in California]." (Pet. App. 8a.) Accordingly, the California securities laws in general, and section 25502.5 in particular, govern conduct occurring in California regardless of where the issuer of the securities is incorporated. (*Id.*) The court did not address Petitioners' newly minted constitutional arguments.

In determining the scope of California's insider trading provisions, the Court of Appeal reviewed the history and application of California's securities regulations system. "For the last 100 years California's corporate securities laws have been applied to foreign corporations who do business in [California] or whose activities in [California] have an impact

on [California's] securities market." (Pet. App. 12a.) To supplement the federal regulation of insider trading, California enacted the Corporate Securities Law of 1968, which included section 25402. (Pet. App. 17a.) California's "prohibition on insider trading was adopted as a means of protecting investor confidence in the securities market and more broadly as a means of punishing what is perceived by the public as immoral conduct." (Pet. App. 25a.) By its terms, section 25402 is limited to securities transactions that occur in California. The California Legislature determined "that the basis of jurisdiction and regulation should be the offer or sale of securities in [California] and *should not be related to the principal place of business or corporate domicile*." (Pet. App. 17a (italics added by court; internal quotation marks omitted).)

As the Court of Appeal explained, several remedies exist for violations of section 25402. For example, section 25502 provides a civil right of action to private plaintiffs duped by insiders engaged in purchasing and selling securities in California in violation of section 25402 (Pet. App. 17a-18a). In 1988, following the "discovery of persistent, systematic insider trading activities yielding millions of dollars in profit to well-known securities professionals" (Pet. App. 16a (internal quotation marks omitted)), the California Legislature added section 25502.5 to provide the same right of action to the issuer of the stock (Pet. App. 18a-19a). The Legislature thus sought to deter insider trading activities in California rather than merely to provide monetary recovery for losses sustained. (Pet. App. 19a.) As the Court of Appeal recognized, the corporation or issuer of stock typically does not suffer money damages when one of its insiders engages in insider trading. "Thus in compelling an officer or director to disgorge to an issuer profits realized by way of insider trading, section 25502.5 does not provide the issuer with compensation for any lost opportunity the issuer itself could have lawfully realized." (Pet. App. 25a-26a.) "The deterrence

provided by this provision clearly demonstrates that in enacting section 25502.5, the Legislature was very much concerned about discouraging conduct it found destructive to the public interest." (Pet App. 26a.)

The court then turned its attention to Petitioners' argument that section 2116 and the internal affairs doctrine prohibit a Delaware corporation from invoking section 25502.5 against its own officers and directors. The internal affairs doctrine is "a conflict of laws principle" under which the internal affairs of a corporation are regulated by the laws of one state to avoid conflicting demands on the corporation. Typically, the laws of the state of incorporation govern. As applied to director's liability, section 2116 is a codification of the internal affairs doctrine. (Pet. App. 20a.) In this regard, the court agreed with Petitioners—"the duties officers and directors owe a corporation are in the first instance defined by the law of the state of incorporation." (Pet. App. 8a.) The court correctly recognized, however, that those duties "are not the subject of California's corporate securities laws in general or section 25502.5 in particular." (Pet. App. 8a.)

Relying on *State Farm Mut. Auto. Ins. v. Superior Court*, 8 Cal. Rptr. 3d 56, 64 (Cal. Ct. App. 2003), the court stated (Pet. App. 20a):

> "Internal affairs" include steps taken in the course of the original incorporation, . . . the adoption of by-laws, the issuance of corporate shares, the holding of directors' and shareholders' meetings, . . . and the declaration and payment of dividends and other distributions, charter amendments, mergers, consolidations, and reorganizations, the reclassification of shares and the purchase and redemption by the corporation of outstanding shares of its stock.

The internal affairs doctrine thus does not govern every issue or dispute involving a corporation's officers or directors. In particular, the Court of Appeal observed, the doctrine does

not preclude enforcement of a forum state's corporate securities laws. (Pet. App. 21a.) Citing Section 309 of the Restatement of Conflicts Second, the court pointed to a state's "blue sky laws" as a common example of state securities regulation that is not displaced by the internal affairs doctrine. (Pet. App. 22a, *quoting* Restatement (Second) of Conflicts § 309 cmt. a (1971).) There is, in short, no incompatibility between the internal affairs doctrine and state insider trading laws like section 25502.5. The internal affairs doctrine addresses the relationship between a corporation and its officers and directors acting within their official capacities; laws like section 25502.5 are triggered when an officer or director steps outside of the bounds of his official duties and engages in insider trading in the State of California to the detriment of the California public and California's securities marketplace.

The Court of Appeal concluded that Petitioners and the trial court failed to appreciate this distinction. The insider trading proscribed by California's statute—the purchase or sale of stock in California for personal profit, at a time when an officer or director has material, non-public information regarding the company—necessarily falls outside the scope of an official corporate duty; it is not part of a corporation's internal affairs. The Court of Appeal explicitly rejected Petitioners' characterization of section 25502.5 "as merely a device for enforcing directors' and officers' fiduciary duties to shareholders." (Pet. App. 25a.) Section 25502.5 neither compensates the corporation for any losses experienced nor provides a means to recover any lawful corporate opportunity. Accordingly, a corporation's claim under the statute is distinct from a derivative breach of fiduciary duty claim. Rather, it "is very much a part of California's corporate securities regulation scheme and serves broad public interests [of deterrence] rather than the more narrow interests of a corporation's shareholders." (Pet. App. 26a.)

Contrary to Petitioners' assertion (Pet. 10-11), the Court of Appeal *did not* disregard the internal affairs doctrine, nor attempt to reach across state lines to tell an out-of-state corporation how to order relationships among the corporation and its directors, officers, and shareholders. The court merely determined that California is entitled to adopt appropriate measures to deter and remedy insider trading violations in California securities transactions.

The court's unanimous decision concluded that a writ of mandate should issue directing the trial court to vacate its order sustaining Petitioners' demurrers to the statutory claims. Under the court's ruling, the trial court now must conduct further proceedings on those claims consistent with the Court of Appeal's opinion. (Pet. App. 26a, 4a.)

The Court of Appeal denied Petitioners' request for rehearing. (Pet. App. 4a.) The California Supreme Court then denied Petitioners' petition for review. (Pet. App. 2a.)

ARGUMENT

Although one would hardly know it from the petition, this is an insider trading case. The conduct at issue involves the trading of stock in California for personal profit. Enacted as part of California's Securities Law of 1968, California Corporations Code § 25402 forbids an "officer, director or controlling person of an issuer" from "purchas[ing] or sell[ing] any security of the issuer in [the State of California] at a time when he knows material information about the issuer gained from such relationship which would significantly affect the market price of that security and which is not generally available to the public." Several enforcement mechanisms provide for actions by investors, civil regulators, and prosecutors. *See, e.g.*, § 25502 (providing private investors a right of action); § 25530 (providing for action by the State Attorney General or Commissioner of Corporations); § 25540 (providing for felony criminal penalties). In 1988,

the California Legislature added to this list suits by the corporate issuer of the relevant security. Section 25502.5 authorizes a corporation to pursue civil sanctions for violations of section 25402. By providing for multiple forms of liability and the possibility of treble damages, the Legislature has put in place several substantial disincentives designed to curb insider trading. Petitioners do not challenge California's prohibition against insider trading in California (section 25402) or any of the remedial provisions allowing actions by shareholders, civil regulators, or criminal prosecutors. Indeed, they concede (Pet. 20) that all of these provisions (and perhaps others as well) are entirely appropriate. Petitioners contend, however, that the Commerce Clause and the Due Process Clause prohibit a state from authorizing a *corporation* to pursue a cause of action against insider trading of the corporation's own securities. In an effort to justify their argument, Petitioners repeatedly mischaracterize the Court of Appeal's holding and the true nature of the claims involved. (*See, e.g.*, Pet. at 2, 10, 14, 20, referring to section 25502.5 claim as a breach of fiduciary duty claim despite explicit rejection of this argument by Court of Appeal; Pet. at 3, 9, 13, stating, in direct contradiction to the court's actual holding, that the court below interpreted section 25502.5 as governing a Delaware corporation's internal affairs.)

Not surprisingly, Petitioners offer no support for their premise that an officer or director acts in his official capacity when he engages in insider trading or sells his own stock for personal gain. (*See, e.g.*, Pet. at 20: "What is at issue here is whether California may abrogate the internal affairs doctrine by permitting an out-of-state corporation to sue its own directors and officers *for conduct in their official capacities* in order to promote California's 'broad public interest.'" (emphasis added).) Without this erroneous premise, Petitioners' attacks on section 25502.5 disintegrate.

The Court of Appeal properly rebuffed Petitioners' attempt to distort California's statutory liability for insider trading into a common law breach of fiduciary duty claim. The internal affairs doctrine "concerns the corporation's organic structure or internal administration." Restatement (Second) of Conflicts § 313 cmt. c (1971). As the Court of Appeal correctly concluded, an officer's or director's misdeeds related to his or her personal sales of stock play no role in the corporation's internal affairs. Because the relevant stock sales took place in the State of California, California properly could apply to the transactions the State's prohibition against insider trading and its remedies for such conduct.

Even apart from the merits, however, the petition faces serious problems. First, this Court currently lacks jurisdiction because the petition seeks review of an interlocutory decision that is not a final judgment within the meaning of 28 U.S.C. § 1257(a). No claim has been finally resolved, and further proceedings are needed in the trial court before any liability can be imposed. Petitioners have denied engaging in any insider trading, and, if their position is sustained in the California courts, their proposed federal constitutional issues will be moot. Second, the federal questions presented are not suitable for review at this stage because Petitioners voluntarily chose not to assert their Commerce Clause and Due Process Clause arguments in their demurrers in the trial court. As a result, none of the state courts actually has addressed Petitioners' constitutional challenges to California's statute. This Court normally will not grant review in these circumstances, and there is no reason to make an exception here.

Putting aside these difficulties, the Court of Appeal's decision is correct and further review is not warranted. The Court of Appeal followed the clear language and intent of California's securities laws, applied controlling precedent, and enforced California's important prohibition against insider trading. Petitioners cite no decision that suggests that a

State's regulation of insider trading within its borders runs afoul of the Commerce Clause or Due Process Clause, or that an officer's or director's personal stock trading is an official duty governed by the internal affairs doctrine and not the forum state's securities regulations.

I. THIS COURT LACKS JURISDICTION TO REVIEW THE INTERLOCUTORY DECISION OF THE CALIFORNIA COURTS.

This Court lacks jurisdiction to review non-final, interlocutory orders of state courts. The interlocutory writ of mandate issued by the California Court of Appeal (and left undisturbed by the California Supreme Court) is just such an order.[8]

Under 28 U.S.C. § 1257(a), this Court's review of state court decisions is confined to "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had . . . where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution." To be eligible for review by this Court, a case must be final in two regards: "it must be subject to no further review or correction in any other state tribunal; it must also be final as an effective determination of the litigation and not of merely interlocutory or intermediate steps therein." *Jefferson v. City of Tarrant*, 522 U.S. 75, 81 (1997) (quoting *Market St. R. Co. v. R.R. Comm'n of Cal.*, 324 U.S. 548, 551 (1945)). In other words, to come within the jurisdiction conferred by section 1257(a), the decision for which review is sought "must be the final word of a final court." *Market St.*

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[8] Writ review in California is by definition interlocutory; it provides a supplementary system for appellate court review of otherwise non-appealable trial court rulings. Unlike traditional appeals, writ review is deemed extraordinary, equitable, and completely discretionary. *See generally Omaha Indem. Co. v. Superior Court*, 258 Cal. Rptr. 66 (Cal. Ct. App. 1989) (explaining the purpose and appropriate use of the court's discretionary exercise of power to grant writ relief).

R. Co., 324 U.S. at 551; *see also Radio Station WOW, Inc. v. Johnson*, 326 U.S. 120, 123-24 (1945) ("This prerequisite to review derives added force when the jurisdiction of this Court is invoked to upset the decision of a State court."); *Collins v. Miller*, 252 U.S. 364, 370 (1920) (the judgment "should be final not only as to all the parties, but as to the whole subject-matter and as to all the causes of action involved").

The decision of the California courts here is not "an effective determination of the litigation." *Jefferson*, 522 U.S. at 81. Far from terminating the litigation, the Court of Appeal resolved a single issue that affected only five of the ten causes of action in Respondent's complaint. Upon overturning the trial court's dismissal of those five counts, the Court of Appeal remanded the case for further proceedings consistent with its order. Absent settlement or further dispositive motions, the proceedings on remand will include a trial on the merits and, more than likely, further appeals. Because only one aspect of the case has been adjudicated in the courts below, "none of it is ripe for review by this court." *Collins*, 252 U.S. at 350. Because the California Court of Appeal "remanded this case for trial, its decision is not final as an effective determination of the litigation." *O'Dell v. Espinoza*, 456 U.S. 430, 430 (1982) (per curiam) (internal quotation marks omitted).

This litigation is ongoing. The trial court granted Respondent leave to amend the five common law causes of action (Pet. App. 30a-31a), and the Court of Appeal reinstated the five statutory insider trading claims (Pet. App. 26a, 4a). Accordingly, as the case comes to this Court, it has not progressed beyond the pleading stage. The underlying facts have yet to be developed, and the trial court has yet to review Petitioners' defenses.

The finality requirement "is not one of those technicalities to be easily scorned. It is an important factor in the smooth working of our federal system." *Jefferson*, 522 U.S. at 81

(quoting *Radio Station WOW*, 326 U.S. at 124). Finality "avoids piecemeal review of state court decisions; it avoids giving advisory opinions in cases where there may be no real 'case' or 'controversy' in the sense of Art. III; it limits review of state court determinations of federal constitutional issues to leave at a minimum federal intrusion in state affairs." *N.D. State Bd. of Pharmacy v. Snyder's Drug Stores, Inc.*, 414 U.S. 156, 159 (1973). The finality requirement additionally "serves an important interest of comity" between the state and federal courts. *Adams v. Robertson*, 520 U.S. 83, 90 (1997) (per curiam) (dismissing writ of certiorari as improvidently granted).

Nor does this case fall within any of the four categories of exceptional cases in which this Court has treated state-court judgments as final for jurisdictional purposes even though further proceedings were to take place in the state court. *See Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 479-84 (1975). The first three categories are inapplicable on their face. *See id.*

First, the federal questions Petitioners attempt to raise here are not "conclusive" nor is the outcome of the proceedings "preordained." *Id.* at 479. Unlike the situation in *Mills v. Alabama*, 384 U.S. 214 (1966), the "prototypical example of this category," *Florida v. Thomas*, 532 U.S. 774, 778 (2001), the further proceedings (including trial) contemplated by the Court of Appeal's opinion will consist of "more than a few formal gestures leading inexorably towards" the predetermined end result. *Mills*, 384 U.S. at 217. Unlike Mr. Mills, Petitioners have not acknowledged that they engaged in the conduct prohibited by state law.

Second, this is not a case in which "the federal issue, finally decided by the highest court of the State, will survive and require decision regardless of the outcome of the future state-court proceedings." *Cox*, 420 U.S. at 480. If Petitioners prevail on their remaining legal and factual arguments, judg-

ment will be entered in their favor, and their federal constitutional issues will be moot.

Third, this case is not one "where the federal claim has been finally decided, with further proceedings on the merits in the state courts to come, but in which later review of the federal issue cannot be had, whatever the ultimate outcome of the case." *Cox*, 420 U.S. at 481. Petitioners remain free to raise their constitutional objections in the trial court, and if judgment is entered in favor of Respondent Friese and against Petitioners, Petitioners may appeal those issues as of right to the California Court of Appeal followed by discretionary review in the California Supreme Court. Thus, the California courts' ultimate "determination will in no way limit [this Court's] ability to review the issue on final judgment." *Jefferson*, 522 U.S. at 84.

The fourth *Cox* category also is inapplicable. Denying review of the decision below will not "seriously erode federal policy" because no immediate or systematic consequences will result from such a delay. Rather, any potential review "can await final judgment without any adverse effect upon important federal interests." *Flynt v. Ohio*, 451 U.S. 619, 622 (1981) (per curiam) (declining to adopt an expansive construction of the exceptions set forth in *Cox*—particularly this fourth exception—that would "swallow the rule" requiring a final judgment).

This case presents "the typical situation in which the state courts have resolved some but not all of petitioners' claims. [This Court's] jurisdiction therefore founders on the rule that a state-court decision is not final unless and until it has effectively determined the entire litigation." *Jefferson*, 522 U.S. at 84.

II. BECAUSE PETITIONERS' CONSTITUTIONAL ARGUMENTS WERE NOT PRESENTED IN THE STATE COURT DEMURRERS, THEY WERE NOT ADDRESSED BY THE COURTS BELOW AND ARE NOT SUITABLE CANDIDATES FOR REVIEW HERE.

Because Petitioners voluntarily elected not to raise their Commerce Clause and Due Process Clause arguments in the trial court, none of the California courts have addressed those arguments, and review in this Court is not warranted. In the Superior Court, the only alleged inkling of Petitioners' constitutional issues came in the form of a footnote in Moores' and JMI's joint demurrer purporting to "reserve all other objections." (Pet. App. 34a-35a.) None of the other Petitioners included any similar footnote, much less properly presented any constitutional arguments in opposition to the application of California law. The most they can point to is the jumble of cross-joinders filed below.

Not surprisingly, given Petitioners' failure to argue the point, the trial court did not address any constitutional issue nor was it obliged to do so. *See* Cal. C. Civ. P. § 430.60 (requiring that a demurrer to a complaint "distinctly specify the grounds upon which any of the objections to the complaint . . . are taken," and authorizing a trial court to "disregard" arguments not properly asserted); Cal. C. Civ. P. § 1010 (requiring a party to state in the notice of motion the grounds upon which the motion will be based); Cal. Rules of Court 311(a) ("A notice of motion shall state in the opening paragraph . . . the grounds for issuance of the order."); *Luri v. Greenwald*, 132 Cal. Rptr. 2d 680, 684-85 (Cal. Ct. App. 2003) (setting forth the general rule in California that "a trial court may consider only the grounds stated in the notice of motion").

The case came to the Court of Appeal on interlocutory writ review, where the Court of Appeal's function is to review the

trial court's order. Petitioners' failure to assert any constitutional issue before the trial court thus set in motion two subsequent layers of review in the California courts directed solely at the issues properly presented at the outset. Petitioners' Commerce Clause and Due Process Clause arguments were not among those issues.

This Court ordinarily does not decide questions "not pressed or passed upon below." *Duignan v. United States*, 274 U.S. 195, 200 (1927). The Court will grant review of such a question "only in exceptional cases." *Id.* This is not an "exceptional case." As a result of Petitioners' failure, not one of the three state courts to review the arguments in this case passed on the merits of the questions presented here by Petitioners. "[W]hen, as here, the highest state court has failed to pass upon a federal question, [this Court] assume[s] that the omission was due to want of proper presentation in the state courts . . . ." *Street v. New York*, 394 U.S. 576, 582 (1969). The party invoking the Court's jurisdiction under these circumstances "has the high burden of showing that the federal question was in fact properly raised." Robert L. Stern et al., SUPREME COURT PRACTICE 175 (8th ed. 2002). Petitioners, having chosen what they wished to include in their demurrers, are unable to meet that high burden. As this Court admonished in *Ackermann v. United States*, 340 U.S. 193, 198 (1950), "free, calculated, deliberate choices are not to be relieved from." Like the petitioner in *Ackermann*, Petitioners should not be relieved from the consequences of their voluntary choice not to raise any constitutional arguments in the trial court.

III. NEITHER THE COMMERCE CLAUSE NOR THE DUE PROCESS CLAUSE PREVENTS THE CALIFORNIA LEGISLATURE FROM SEEKING TO DETER AND REMEDY INSIDER TRADING IN CALIFORNIA BY GRANTING A CAUSE OF ACTION TO THE CORPORATION WHOSE SECURITIES WERE UNLAWFULLY PURCHASED OR SOLD IN CALIFORNIA.

Even putting aside all of the procedural infirmities, Petitioners' arguments on the merits are unavailing. In an effort to demonstrate that California law, namely section 25502.5, as interpreted by the California courts, violates the Commerce Clause and Due Process Clause, Petitioners begin with the faulty premise that sections 25402 and 25502.5 regulate the official duties of corporate officers and directors. The Court of Appeal properly rejected this argument, and Petitioners offer no support for it here. Nor is there any reason to think that it is part of the official duty of a corporate officer or director to purchase or sell stock in California for personal gain.

Sections 25402 and 25502.5 proscribe insider trading in the State of California. These provisions are aimed at protecting California's "legitimate and compelling interest in preserving a business climate free of fraud" and curbing deceptive practices in the State. *Diamond Multimedia Sys., Inc. v. Superior Court*, 19 Cal. 4th 1036, 1064 (Cal.), *cert. denied*, 527 U.S. 1033 (1999). The California Legislature enacted section 25502.5 in an effort to send a "loud and clear message":

> Inside trading on the securities market is a very serious crime, and yet the current civil and criminal penalties amount to no more than a slap on the wrist for those who commit this crime. Senate Bill 2578 sends a loud and clear message to "would be" inside traders that such practices will not be tolerated in California.

S.B. 2578, Floor Statement, 1987-88 Reg. Sess. (Cal. 1988).

Recognizing that corporations have a significant interest in protecting California's securities marketplace and maintaining California investor confidence, the Legislature deputized the issuer corporation to assist in deterring insider trading in the corporation's securities in California. Section 25502.5 authorizes the corporation to enforce section 25402 against *any* violator whose relationship with the issuer provides access to non-public, material information. The statute in essence creates a private attorney general mechanism and provides an incentive in the form of treble damages to encourage corporations to assist in the enforcement and regulation of the State's securities market.

Because sections 25402 and 25502.5 regulate only conduct occurring within California, they do not discriminate against or impose an impermissible burden on interstate commerce "by subjecting activities to inconsistent regulations." *See CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 88 (1987); *see also Diamond Multimedia Sys.*, 19 Cal. 4th at 1064 (rejecting Commerce Clause challenge to related securities provisions, sections 25400 and 25500). States may regulate in-state portions of interstate transactions as long as the regulation furthers a legitimate state interest. *See Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Any indirect burden that these securities provisions place on out-of-state commerce "is clearly offset by the state interest in preventing fraud and protecting the integrity of the capital market for all investors." *Diamond Multimedia Sys.*, 19 Cal. 4th at 1064. Even Petitioners agree that "the Commerce Clause is not offended" by a State's application of its blue-sky laws to securities issued by an out-of-state corporation but sold within the State. (Pet. 19.)

Petitioners' due process challenge is equally flawed. Petitioners contend that they "could not possibly have anticipated the novel California liability" they have encountered as a result of their unlawful conduct. (Pet. 21.) That is an odd

contention indeed, given that the challenged California statutory provision was enacted a decade before the trading at issue. Petitioners concede, moreover, that "California is of course free to pursue its [interests] against insider trading through any number of . . . mechanisms" contained within the Corporations Code. (Pet. 20.) Petitioners' illicit behavior in California subjected them to liability in California, regardless of whether the plaintiff holding them accountable is the California Attorney General, the California Securities Commissioner, a private investor, or the issuer corporation. Petitioners' alleged subjective belief that they could not be sued on behalf of Peregrine under California law, apart from being entirely self-serving, cannot create a due process violation or otherwise inoculate Petitioners against the application of California law to securities transactions in California.

Finally, there is no conflict among the circuits with regard to either of the issues that Petitioners seek to present, no conflict with general federal policy, and no conflict with any decision of this Court. Petitioners' principal thesis is that tensions exist between California and Delaware decisions concerning the interpretation of the internal affairs doctrine. (Pet. 10.) Any such tension is not at issue here, primarily because the Court of Appeal correctly concluded that the internal affairs doctrine has no application to private securities trading and enforcement of a state's corporate securities laws.

Relying solely on *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005), for their purported conflict, Petitioners look to find disagreement where none exists. The court in *VantagePoint* did not even suggest, much less hold, that section 25502.5 violates the Constitution. Indeed, as Petitioners concede, *VantagePoint* "involves a different provision of the California Corporations Code;" the Delaware courts have not addressed the provisions at issue here. (Pet. 13.) On the contrary, the Delaware and California

courts are in agreement where there is any overlap in their analysis.

Both the *VantagePoint* court and the California courts recognize and, when relevant follow, the internal affairs doctrine. The court in *VantagePoint* was asked whether a shareholder of preferred stock had a right to vote by separate class of stock regarding a corporate merger. The court had no difficulty determining that "the legal issue in this case . . . clearly involves the relationship among a corporation and its shareholders." 871 A.2d at 1115-16. As a result, the court relied on the internal affairs doctrine in the remainder of its analysis.

Here, by contrast, the California Court of Appeal correctly concluded that the internal affairs doctrine "does not apply to individual transactions between a director and . . . shareholder, such as where a director purchases shares from the shareholder for his personal account." Restatement (Second) of Conflicts § 309 cmt. a (1971). Faced with allegations of personal stock sales for personal gain, the court properly determined that this behavior does not implicate internal corporate affairs or the official duties of a corporate officer or director, and thus is not governed by the internal affairs doctrine. (Pet. App. 24a-26a.)

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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